DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 03-0381
Indiana Corporate Income Tax
For the Years 1999, 2000, and 2001

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ISSUES

I. **Resource Recovery System Credit** – Gross Income Tax.

Authority: IC 6-2.1-4-3; IC 6-2.1-4-3(a); IC 6-2.1-4-3(b); IC 13-11-2-99(a); IC 13-11-2-205(a); Black's Law Dictionary (7th ed. 1999); American Heritage Dictionary (1st ed. 1969).

Taxpayer argues that the Department of Revenue erred when it disallowed taxpayer's depreciation deduction for its resource recovery system.

II. **Abatement of the Ten-Percent Negligence Penalty**.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer asks that the Department of Revenue exercise its discretion to abate the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana company in the business of manufacturing aluminum wheels. The Department of Revenue (Department) conducted a review of taxpayer's state income tax returns. That review resulted in the assessment of additional Indiana corporate income taxes. Taxpayer disagreed with the Department's conclusions reached during this initial review and with the consequent additional assessments. Accordingly, taxpayer submitted a protest to that effect, an administrative hearing was conducted during which taxpayer explained the basis for its protest, and this Letter of Findings results.

DISCUSSION

I. **Resource Recovery System Credit** – Gross Income Tax.

Taxpayer manufactures aluminum automobile wheels. Taxpayer does so by melting aluminum ingots in its furnaces and pouring the molten aluminum into gravity molds. After the aluminum has cooled, the partially finished wheels are removed from the molds. Taxpayer then machines

the partially finished wheels to remove excess aluminum. During this machining, chemical coolants are sprayed on the wheels. A certain amount of the coolant remains on the aluminum shavings. The contaminated aluminum shavings are collected by a series of conveyors and placed in bins. According to taxpayer, it cannot use the contaminated aluminum shavings until the coolant residue is removed. Because it lacks the capacity to do so itself, taxpayer sends the contaminated shavings to a third-party processor which is equipped to remove the contaminants. The third-party processor treats the aluminum shavings, taxpayer pays third-party processor a fee for this service, and the third-party processor returns the decontaminated shavings – in the form of newly cast ingots – to taxpayer. The newly formed ingots are now suitable for reintroduction into taxpayer's manufacturing process.

Taxpayer maintains that, by virtue of its manufacturing and reclamation process, it operates a "resource recovery system" (RRS). Therefore, taxpayer originally claimed a credit for its RRS against receipts subject to Indiana gross income tax equal to the amount of depreciation of the RRS taken on its federal returns.

The Department's review of taxpayer's income tax returns concluded that taxpayer was not entitled to take the credit because taxpayer's treatment of the contaminated aluminum shavings "[did] not qualify for the resource recovery credit." The Department found that any "resource recovery system" must process solid waste or hazardous waste and that the term "waste" was defined as "a worthless or useless by-product such as garbage or trash." The Department concluded that the aluminum shavings were not "waste" because the shavings had value to the taxpayer. According to the Department's initial report, "Waste does not include scrap."

Taxpayer claimed the RRS credit under the authority provided for in IC 6-2.1-4-3. The statute states in relevant part as follows:

> If for federal income tax purposes a taxpayer is allowed a depreciation deduction for a particular taxable year with respect to a RRS, and if the resource recovery system processes solid waste or hazardous waste, the taxpayer is entitled to a deduction from his gross income for that same taxable year. IC 6-2.1-4-3(b).

Therefore, in order for any taxpayer to claim the credit, that taxpayer must (1) operate a RRS, (2) the taxpayer must have been allowed a federal credit, and (3) the RRS must process "solid waste or hazardous waste."

The statute sets out the criteria under which the taxpayer may claim the credit. "'Hazardous waste' has the meaning set forth in IC 13-11-2-99(a) and includes a waste determined to be hazardous waste under IC 13-22-2-3(b)." IC 6-2.1-4-3(a).

IC 13-11-2-99(a) states that the term "hazardous waste" means:

> a solid waste or combination of solid wastes that, because of its quantity, concentration, or physical, chemical, or infectious characteristics, may: (1) cause or significantly contribute to an increase in: (A) mortality; (B) serious irreversible illness; or (C) incapacitating reversible illness; or (2) pose a substantial present or potential hazard to

> (A) human health; or (B) the environment; when improperly treated, stored, transported, disposed of, or otherwise managed.

In addition, the RRS statute defines "solid waste" stating that "'Solid' waste has the meaning prescribed by IC 13-11-2-205(a) but does not include dead animals or any animal solid or semisolid wastes." IC 6-2.1-4-3(a).

IC 13-11-2-205(a) states in part that "'Solid waste', for purposes of IC 13-19, IC 13-21, IC 13-20-22, and environmental management laws . . . means any garbage, refuse, sludge from a waste treatment plant, sludge from a water supply plant, sludge from an air pollution control facility, or other discarded material including solid, liquid, semisolid, or contained gaseous material resulting from industrial, commercial, mining, or agricultural operations or from community activities."

In enacting IC 6-2.1-4-3, the Legislature limited the availability of the depreciation credit to those taxpayers which process either "hazardous waste" or "solid waste."

Taxpayer contends that the contaminated aluminum shavings are "waste" because – in their unprocessed form – they have no value to the taxpayer. According to taxpayer, the contaminated aluminum shavings have "less than no value" because the contaminated shavings represent the cost of eliminating the coolant chemicals.

The Department must disagree with the taxpayer on two grounds. Under the plain reading of the statute, both "hazardous waste" and "solid waste" constitute substances which have no intrinsic value. The definition of waste is that it constitutes "[r]efuse or superfluous material, esp[cially] that remaining after a manufacturing or chemical process." Black's Law Dictionary 1584 (7th ed. 1999). ("Any useless or worthless byproduct of a process or the like; refuse or excess material." American Heritage Dictionary 1447 (1st ed. 1969)). Therefore, in order to claim the gross income tax credit provided for under IC 6-2.1-4-3, the claimant taxpayer must have purchased and be operating a system that processes worthless, discarded materials.

The Department must also disagree with taxpayer's contention that the contaminated aluminum shavings have no value. Merely because it costs money to process the contaminated aluminum shavings does not mean that the shavings are valueless, discarded waste. Indeed, there are costs other than the expense of removing the coolant residue such as the cost of transporting the shavings to and from the third-party processor, the cost of reforming the shavings into manageable ingots, and the cost of resmelting the ingots at the time they are reintroduced into taxpayer's manufacturing process. Simply because it costs money to process and reintroduce the aluminum shavings does not mean that the shavings are valueless. Indeed, the entire point of this exercise is that the shavings do have an inherent value which justifies the expense of salvaging the raw aluminum and forming the recovered aluminum into salable wheels.

In addition to the above-noted objections, the Department must point out that it is entirely unclear as to just what it is that taxpayer is depreciating. IC 6-2.1-4-3 provides a credit for the depreciation of a RRS. However, from taxpayer's description of its manufacturing process, it is uncertain whether taxpayer has a RRS because the operation to remove the hazardous coolants is

performed entirely by a third-party processor. Taxpayer appears to be operating a straight-forward manufacturing system. Other than placing the contaminated shavings into bins, it is unclear what sort of "system" it operates to reprocess these aluminum shavings.

FINDING

Taxpayer's protest is respectfully denied.

II. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer asks that the Department abate the ten-percent negligence penalty because in interpreting the "plain language of the resource recovery statute in taking a deduction . . . [it was] acting due to reasonable cause and not willful neglect."

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

During a previous audit of its 1996 and 1997 returns, taxpayer was denied the RRS credit for purposes of calculating its gross income tax. The audit did so on the ground that its system did not qualify as a RRS because the system did not process valueless waste. Nonetheless, taxpayer claimed an identical credit based upon identical grounds on its 1999, 2000, and 2001 returns. Although taxpayer and the Department may continue to disagree concerning the applicability of the RRS credit, the Department is unable to conclude that taxpayer's decision to claim a previously disallowed credit constitutes "ordinary business care."

FINDING

Taxpayer's protest is respectfully denied.

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